

LEGAL UPDATE 14/2010: TAXATION OF WITHDRAWAL BENEFITS PRIOR TO RETIREMENT

From 1 March 2009, withdrawal benefits are taxed in a much simpler way, based on a table similar to that applying in respect of retirement benefits, with the exception that only R22 500 will be allowed tax free for pre-retirement withdrawals. The benefit will therefore be taxed as follows:

- First R22 500 = 0% (tax free)
- Difference between R22 501 and R600 000 = 18%
- Difference between R600 001 and R900 000 = 27%
- Amount over R900 000 = 36%

The above applies cumulatively over the lifetime of the member, which *inter alia* means that the tax-free amount only applies to the extent that it has not been depleted in respect of previous withdrawal benefits after 1 March 2009.

Transfers between funds

The following transfers are regarded as “tax-free”:

From	To
Pension fund	Pension fund Pension preservation fund Retirement annuity fund
Pension preservation fund	Pension fund Pension preservation fund
Provident fund	Pension fund Provident fund Provident preservation fund Retirement annuity fund
Provident preservation fund	Provident fund Provident preservation fund
Retirement annuity fund	Retirement annuity fund

Simpler taxation from 1 March 2009

Tax free transfers

Please also note that the following transfers are not allowed:

From	To
Pension preservation fund	Provident preservation fund Provident fund Retirement annuity fund
Provident preservation fund	Pension fund Pension preservation fund Retirement annuity fund
Retirement annuity fund	Provident preservation fund Provident fund Pension fund Pension preservation fund

Transfers from pension fund to provident fund

When a member transfers from a pension fund to a provident fund their total benefit in the pension fund is taxed as it is seen as a cash withdrawal by SARS.

Upon **withdrawal from the provident fund** the amount transferred from the pension fund will qualify as the member's own contribution to the provident fund that did not previously qualify as a deduction in terms of the provisions of paragraph 6(1)(b)(i) of the Second Schedule to the Income Tax Act, No 62 of 1958. Therefore, although the member was taxed upon transfer to the provident fund, that same amount qualifies for a deduction in determining the amount to be included in their gross income when they withdraw from the provident fund.

Example

Joe transfers R100 000 from a pension fund to a provident fund in November 2010.

His total benefit of R100 000 is taxable according to the withdrawal table:

Portion of benefit	Tax rate	Tax payable
R22 500	0%	0
R77 500	18%	R13 950

The amount of R86 050 (R100 000 – R13 950) transferred to the provident fund will be deemed to be Joe's own contribution towards the provident fund.

Joe then exits the provident fund 5 years later in 2015 and is eligible for a benefit of R250 000. His contributions towards the provident fund was R50 000. This does not include the pension fund transfer.

Transfers not allowed

Benefit taxed upon transfer

Deduction on withdrawal

Taxation of pension fund benefit

Taxation of provident fund benefit

There are three steps to follow in calculating the tax and hypothetical tax.

Step 1 is the tax on the aggregation of this and all previous lump sums.

Step 2 is the tax calculated on all previous lump sums after 1 October 2007 (retirement benefits) and 1 March 2009 (resignation benefits).

Step 3 is subtracting the answer to step 2 from step 1.

Step 1: Add first and second benefits

R250 000 + R100 000 = R350 000

Less deductions under paragraph 6:

Member's own contributions that did not previously rank as a deduction:

R50 000 contribution towards provident fund + R86 050 deemed contribution = R136 050

Taxation of balance of benefit – R213 950 (R350 000 – R136 050)

Portion of benefit	Tax rate	Tax payable
R22 500	0%	0
R191 450	18%	R34 461

Step 2: Tax calculated on previous November 2010 pension fund resignation benefit

Already calculated = R13 950

Step 3: Tax payable on provident fund benefit

= Step 1 answer – step 2 answer
= R34 461 – R13 950
= R20 511

Anthea Mara
Legal Adviser
Momentum BenefitsAtWork

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